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Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

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This past week has taken the financial markets through bizarre twists and turns that underline the financial precariousness of the times. The long-term markets refuse to settle down; bonds continue to register successively deeper discounts. Despite the clear signal that the markets fear large federal deficits, there is no evidence of substantial progress on this matter. Adding to this anxiety has been concern over the financial system, particularly a jitteriness about banks. This feeling persists even after the Fed and other regulators rushed to the aid of Continental Illinois. What do we learn from watching these market forces?

The most obvious signal here is that markets are unsettled. As rumors of further banking problems circulated on Thursday, the dollar fell from DM2.74 to as far as DM2.70, a fairly precipitous drop for one day. A wide range of bank stocks fell on bad times, and spreads widened sharply between the yields on three-month Treasury bills and on other open market paper. The catalyst for these events seems to have been an announcement by a Treasury spokesman to the effect that U.S. participation in an aid package for Argentina was less likely than had been thought before. But why should we get such a reaction to this statement?

The rationale is lacking here. Instead of logical, carefully distinguished credit judgments, we see the market overly reactive to public announcements in the bluntest way possible. The Treasury spokesman's statement (later modified) was not reassuring. But the Fed has been so quick to act, and regulators so comprehensive in their support of Continental Illinois, that it is hard to see why there are such strong perceptions of risk by the market. This is not to deny the phenomenon but to confront the nature of this fear.

The FOMC met earlier this week and set a course for monetary policy. Certainly this atmosphere of anxiety pervaded the Committee's deliberations. Recent events have indeed put the Fed between "a rock and a hard place." Financial distress calls for them to ease, even if the distress is more perceived than real. But the large budget deficits raise fears of the opposite kind: fears of inflation. To calm these fears, policy must remain taut.

One thing we can be sure of is that short-term factors will dominate if they become of great enough concern. This tilts the Fed toward ease to take pressure off the financial structure. The growth of aggregate demand in the economy may be strong, but financial problems are deep-rooted. The events of the past few years took a toll on financial and nonfinancial corporations as well as on the LDCs. Economic strength is mostly confined to the U.S., stimulated by tax cuts and large fiscal deficits. The rest of the world needs this stimulus, but growth in the U.S. must slow its rapid pace. Clearly it will take more than just monetary policy to accomplish all of these goals, but for now the Fed is alone.

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Market Yields

	5/25/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	12.50	12.50%	10.50
Effective since	5/8/84		
Discount Rate at Federal Reserve Bank	9.00	9.00	8.50
Federal Funds	10.00	9.25	8.50
Repurchase Agreements	9.13	8.63	8.13
U.S. Treasury Issues			
Bills			
3 months	10.16	10.18	8.74
6 months	11.17	10.94	9.01
1 year	11.94	11.66	9.23
Coupons			
2 years	12.81	12.47	9.86
4 years	13.29	12.99	10.18
7 years	13.64	13.38	10.54
10 years	13.80	13.47	10.58
Long Bond	13.80	13.48	10.74
Negotiable Certificates of Deposit-Secondary Market			
1 month	10.40	10.50	8.65
3 months	11.30	11.10	8.80
6 months	11.85	11.70	9.10
1 year	12.65	12.25	9.40
Banker's Acceptances			
1 month	10.50	10.59	8.66
3 months	11.20	11.21	8.85
6 months	12.00	11.86	9.10
Eurodollar Deposits			
1 month	10.88	10.75	9.06
2 months	11.25	10.38	9.13
3 months	11.75	10.69	9.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.01	8.76	8.63
1 month	10.39	10.29	8.68
3 months	10.99	11.05	8.81
Bank Holding Companies			
1 month	10.08	9.93	8.30
Dealer Placed:			
3 months	10.68	11.21	8.89
New AA Corporate Utility Bond	14.90	14.85	11.65
Tax Exempt			
6 month Project Notes	5.85	5.80	4.75
1 year AAA Bond	6.70	6.50	5.50
5 year AAA Bond	8.05	7.80	7.00
20 year AAA Bond	10.40	9.90	9.10

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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